

USAID Grant Number 391-005-ES-07

PROGRAM ASSISTANCE GRANT AGREEMENT

BETWEEN THE

UNITED STATES OF AMERICA

AND THE

ISLAMIC REPUBLIC OF PAKISTAN

Islamic Republic of Pakistan)
City of Islamabad) SS:
Embassy of the)
United States of America)

I, Vice Consul of the United States of America at Islamabad, Pakistan duly commissioned and qualified, do hereby certify that the foregoing is a true and faithful copy of the original, the same having been carefully examined by me and compared with the said original and found to agree therewith word for word and figure for figure.

IN WITNESS WHEREOF I have here unto set my hand and affixed the seal of the Embassy of the United States of America at Islamabad, Pakistan, this 20 day of JUNE 2007

[Signature]
VICE CONSUL OF THE UNITED STATES OF AMERICA

Dated: June 15, 2007

Fiscal Data:
Phoenix Obligation No: 391-SO-391-005-ES-07

FUNDS AVAILABLE	
OFM / Accounting Section	
Amount:	\$ 2,000,000.00
P02 MRB JUN 2007	
< > Context Clearance only	
Posted By:	On: 06/15
Cleared By:	On: 06/14
MACS/PNX TRNTYP: CO / CT	

2007/2008 ES
\$85,300,000
Program Area A11
391-M

2007/2008 ES
\$64,700,000
Program Area A12
391-M

2007/2008 ES
\$50,000,000
Program Area A22
391-M

USAID Grant No. 391-005-ES-07

Program Assistance Grant Agreement (this "Agreement")

Dated: June 15, 2007

Between

The United States of America, acting through the U.S. Agency for International Development ("USAID")

And

The Islamic Republic of Pakistan (the "Grantee" and together with USAID, the "Parties")

ARTICLE I. The Grant

(a) The purpose of this Agreement is to provide economic support assistance to the Grantee to facilitate the implementation of the shared objectives related to the Grantee's second generation poverty reduction and social development program described in the October 1, 2004 letter from the Grantee's Minister of Economic Affairs and Statistics (Economic Affairs Division) to the U.S. State Department's Under Secretary of State for Economic Affairs (attached as Appendix 1 to this Agreement). The October 1, 2004 letter states that each year there is to be a review of reforms that would facilitate the release of additional budgetary assistance. That review has been conducted and the resulting shared objectives of the Parties for the Grantee's fiscal year 2007 (July 2006 – June 2007) are set forth in Appendix 2 to this Agreement (referred to hereinafter as the "Shared Objectives").

(b) In order to support the Shared Objectives, and pursuant to the Foreign Assistance Act of 1961, as amended, USAID hereby grants to the Grantee under the terms of this Agreement an amount not to exceed Two Hundred Million United States (U.S.) Dollars (\$200,000,000) (the "Grant").

ARTICLE II. Disbursement of the Grant

SECTION 2.1. Conditions Precedent to Disbursement

Prior to the disbursement of the Grant, or to the issuance by USAID of documentation pursuant to which such disbursement will be made, the Grantee

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shall, except as the Parties may otherwise agree in writing, furnish to USAID, in form and substance satisfactory to USAID, the following:

(a) A statement of the name of the person holding the office specified in Section 6.5, and of any additional representatives, together with a specimen signature of each person so designated;

(b) Evidence that the Grantee has established a Separate Dollar Account described in Article III of this Agreement, including (i) the name and address of the bank, (ii) the name and number of the account including bank routing number, (iii) the names and titles of officials authorized to make withdrawals, (iv) a statement of the means by which funds will be withdrawn from the account, (v) a statement that the Grantee will maintain the bank account in the manner required by Section 3.1, and (vi) a statement from the bank confirming that the account has been established, that the Grantee cannot open a non-interest bearing U.S. Dollar account, and that the bank has received instructions from the Grantee that it shall remit any interest accrued on any amounts held in the U.S. Dollar Account to the U.S. Treasury for the account indicated by USAID;

(c) Confirmation that satisfactory progress has been made toward achieving the Shared Objectives;

(d) Execution of the Consolidated, Amended and Restated Trust Account Agreement between the Grantee and USAID substantially in the form attached hereto as Appendix 3 to this Agreement. As specified in Section 4.2, under the Consolidated, Amended and Restated Trust Account Agreement, the Pakistani Rupee equivalent of not less than one million U.S. Dollars from the Special Local Currency Account described in Article IV of this Agreement will be deposited to an account identified by USAID and copies of the documentation prepared in advance to implement the transfer of such funds to USAID in trust for the purposes identified in the Consolidated, Amended and Restated Trust Account Agreement; and

(e) A written statement setting forth (i) the specific line item(s) in support of the Shared Objectives in the Grantee's budget for the fiscal year ending June 30, 2008 to which the Pakistani Rupees in the Special Local Currency Account, less the amount transferred to USAID pursuant to Section 4.2, will be applied and the amounts allocated to such line items both prior and subsequent to inclusion of such Rupees and (ii) the uses of the Grant Proceeds (as defined in Section 2.2) that are to be included in the Program Implementation Letter referred to in Section 3.2.

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SECTION 2.2. Disbursement

Upon satisfaction of the conditions precedent set forth in Section 2.1, USAID will disburse the amount of the Grant into the Separate Dollar Account established pursuant to Section 3.1 (such deposited U.S. dollars are sometimes referred to herein as the "Grant Proceeds".)

SECTION 2.3. Terminal Date for Disbursement

USAID will promptly notify the Grantee when the conditions precedent specified in Section 2.1 have been met. If the conditions precedent specified for the disbursement of the Grant have not been met within ninety (90) days from the date of this Agreement, or such other date as the Parties may agree to in writing, USAID may terminate this Agreement by written notice to the Grantee.

ARTICLE III. The Separate Dollar Account

SECTION 3.1. Establishing the Separate Dollar Account

(a) The Grantee agrees to establish a separate U.S. Dollar account in the Federal Reserve Bank of New York (the "Separate Dollar Account") for deposit of the Grant, and shall not commingle the Grant with funds from any other source.

(b) USAID has been informed by the Grantee that the Federal Reserve Bank of New York will not permit the Grantee to open a non-interest bearing account. As a result, the Grantee shall instruct the Federal Reserve Bank of New York to remit any interest generated by any funds held in the Separate Dollar Account immediately upon generation to the Treasury of the United States of America ("U.S. Treasury") and shall notify USAID of each amount of interest generated and provide documentation of its remittance to the U.S. Treasury no later than the end of each month in which such interest is generated. The Grantee shall not use the interest for any purpose, including the Shared Objectives.

SECTION 3.2. Dollar Uses

The Grantee agrees to use the Grant Proceeds exclusively for the uses set forth in a subsequent Program Implementation Letter issued in accordance with Section 6.2, except as USAID otherwise agrees in writing.

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ARTICLE IV. The Special Local Currency Account

SECTION 4.1. Establishing the Account

The Grantee agrees to establish a separate account in the State Bank of Pakistan (the "Special Local Currency Account"). Upon withdrawal of dollars from the Separate Dollar Account in accordance with Section 3.2, the Grantee shall deposit into the Special Local Currency Account an equivalent amount of Pakistani Rupees at the weighted average bid rate of the State Bank of Pakistan at the end of the preceding business day.

SECTION 4.2. Local Currency Uses

The deposited Pakistani Rupees will be jointly programmed by USAID and the Grantee for budget support to the specific budget line items that will be agreed to by the Parties in a subsequent Program Implementation Letter issued in accordance with Section 6.2; provided, however, that the Grantee agrees that, in connection with the initial deposit of Pakistani Rupees under Article IV, it will transfer to USAID in trust not less than the Pakistani Rupee equivalent of one million U.S. Dollars (\$1,000,000) to be used for the administrative, operating and other costs of the USAID program in Pakistan, as more fully described in the Consolidated, Amended and Restated Trust Account Agreement required under Section 2.1(d). The budget line items agreed to by the Parties must support achievement of the Shared Objectives.

ARTICLE V. Accounting and Reporting

SECTION 5.1. Accounting Books and Records

The Grantee shall maintain, or cause to be maintained, in accordance with its laws and regulations and generally accepted accounting principles and practices, documents in support of deposits to and withdrawals from the Separate Dollar Account and the Special Local Currency Account. Such documents shall be available for review and audit by USAID, or its designees, at the end of each fiscal year of the Grantee and at such other times as USAID may request and for up to three years following the last withdrawal from the applicable accounts made in accordance with the provisions of this Agreement. Additional review and audit requirements may be established in Program Implementation Letters issued in accordance with Section 6.2.

SECTION 5.2. Reporting

Except as the Parties may otherwise agree in writing, the Grantee shall provide USAID with quarterly reports on the uses of Separate Dollar Account and Special Local Currency Account funds and the status of the Separate Dollar Account and Special Local Currency Account until the funds are fully withdrawn

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and applied for the agreed-to purposes specified in the Program Implementation Letter(s) referenced in Articles III and IV. Such report will include all deposits into and withdrawals from the accounts as well as a report on the deposit of Pakistani Rupees into the Special Local Currency Account and the immediate application of such Rupees for the purposes set forth in Article IV and a Program Implementation Letter, as described in Article IV. The quarterly reports will also provide the amount of expenditures that Grantee made using such Rupees in the previous quarter with respect to the budget line items set forth in the Program Implementation Letter described in Section 4.2. Additional reporting requirements and formats may be established in Program Implementation Letters issued in accordance with Section 6.2.

ARTICLE VI. Miscellaneous

SECTION 6.1. Taxation

This Agreement and the Grant shall be free from any taxation or fees imposed under laws in effect in the territory of the Grantee. No Grant Proceeds, nor any local currency deposited in connection with the Grant pursuant to Section 4.1, shall be used to pay taxes, customs duties or other fees applied by Grantee's authorities to commodities procured with Grant Proceeds.

SECTION 6.2. Program Implementation Letters

USAID may from time to time issue "Program Implementation Letters" elaborating on terms of this Agreement, further describing applicable procedures, or recording agreement of the Parties on details of implementation. Program Implementation Letters will not be used to amend the text of this Agreement, but can be used to amend Appendix 2 and record revisions and exceptions which are permitted by this Agreement.

SECTION 6.3. Non Waiver of Remedies

No delay in exercising any right or remedy accruing to a Party in connection with this Agreement will be construed as a waiver of such right or remedy.

SECTION 6.4. Consultation

The Parties will cooperate to ensure that the purposes of this Agreement are accomplished. To this end, the Parties, at the request of either, will exchange views on the progress of this Agreement, and other matters related to this Agreement.

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SECTION 6.5. Representatives

For all purposes relevant to the implementation of this Agreement, the Grantee will be represented by the individual holding or acting in the office of the Secretary, Ministry of Economic Affairs and Statistics (Economic Affairs Division), and USAID will be represented by the individual holding or acting in the office of the Director, USAID Mission to Pakistan, each of whom, by written notice, may designate additional representatives for all purposes other than signing formal amendments to this Agreement. Either party may accept as authorized any instrument signed by such representatives of the other Party in implementation of this Agreement, until receipt of written notice of revocation of their authority.

SECTION 6.6. Prohibited Uses; Replenishment of Funds

(a) Both the Grantee and USAID are firmly committed to the international fight against terrorism, and in particular, against the financing of terrorism. It is the policy of USAID and the Grantee to seek to ensure that none of its funds are used, directly or indirectly, to provide support to individuals or entities associated with terrorism. In accordance with this policy, the Grantee undertakes to use reasonable efforts to ensure that none of the Grant Proceeds are used to provide support to individuals or entities associated with terrorism.

(b) In addition, Grant Proceeds may not be used to finance the purchase of services, commodities or equipment (x) for the use or benefit of any military, paramilitary, police, prison or law enforcement force or for any military or paramilitary purpose or (y) from any country identified as a foreign policy restricted country in Section 228.03(b) of Part 228, Rules on Source, Origin and Nationality for Commodities and Services Financed by USAID, as amended by USAID from time to time. Grant Proceeds may not be used to finance the purchase of surveillance equipment, abortion equipment, luxury goods and gambling equipment, or weather modification equipment; nor may Grant Proceeds be used for (a) any activity that involves investment promotion, unless specifically authorized by USAID, or which would contribute to a violation of internationally recognized rights of workers, or (b) for purposes other than those authorized pursuant to Article III or a Program Implementation Letter, as described in Article III.

(c) In the case of any utilization of Grant Proceeds which is not supported by valid documentation in accordance with this Agreement and/or any applicable Program Implementation Letter(s) issued thereunder, or which is not made or used in accordance with this Agreement and/or any applicable Program Implementation Letter(s) issued thereunder, the Grantee agrees to redeposit, within sixty (60) days after receiving notification from USAID of such breach, to the Separate Dollar Account described in Article III of this Agreement, an equivalent amount of U.S. Dollars. Funds so redeposited shall be considered by

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the Parties as Grant Proceeds and shall be used for purposes permitted under this Agreement and/or any applicable Program Implementation Letter(s).

(d) Similarly, if any utilization of funds in the Special Local Currency Account is not in accordance with this Agreement and/or any applicable Program Implementation Letter(s) issued thereunder or is not supported by valid documentation in accordance with this Agreement and/or any applicable Program Implementation Letter(s) issued thereunder, the Grantee agrees to redeposit, within sixty (60) days after receiving notification from USAID of such breach, to the Special Local Currency Account described in Article IV of this Agreement, an equivalent amount of Pakistani Rupees. Funds so redeposited shall be used for purposes permitted under this Agreement and/or any applicable Program Implementation Letter(s).

SECTION 6.7. Communications

Any notice, request, document, or other communication submitted by either Party to the other under this Agreement will be transmitted by certified mail, or by fax followed by certified mail in case of urgency, and will be deemed duly given or sent when delivered to such party at the following addresses, as applicable:

To the Grantee:

Secretary,
Ministry of Economic Affairs and Statistics
(Economic Affairs Division)
Government of Pakistan
Block "C", Pakistan Secretariat
Islamabad, Pakistan
Telephone No. 921-0629
Fax No. 920-5971

To USAID:

Director,
USAID Mission to Pakistan
American Embassy
Islamabad, Pakistan
Telephone No. 208-2012
Fax No. 287-0310

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With a copy to:

Embassy of the United States of America
Attn: Economic Counselor
Islamabad, Pakistan

All such communications will be in English, unless the Parties otherwise agree in writing. Other addressees may be substituted for the above upon the giving of written notice.

SECTION 6.8. Amendment

Except as otherwise provided in Section 6.2, this Agreement may only be amended by the execution of written amendments by the authorized representatives of both the Parties designated in Section 6.5.

SECTION 6.9. Effective Date

This Agreement shall enter into force following signature by both Parties hereto as of the day and year first above written.

[Signature Page Follows]

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IN WITNESS WHEREOF, the Islamic Republic of Pakistan and the United States of America, each acting through its duly authorized representative, have caused this Agreement to be signed in their names and delivered as of the day and year first above written.

The United States of America

The Islamic Republic of Pakistan

By: *Anne Aarnes*
Name: Anne Aarnes
Title: Director
USAID Mission to Pakistan

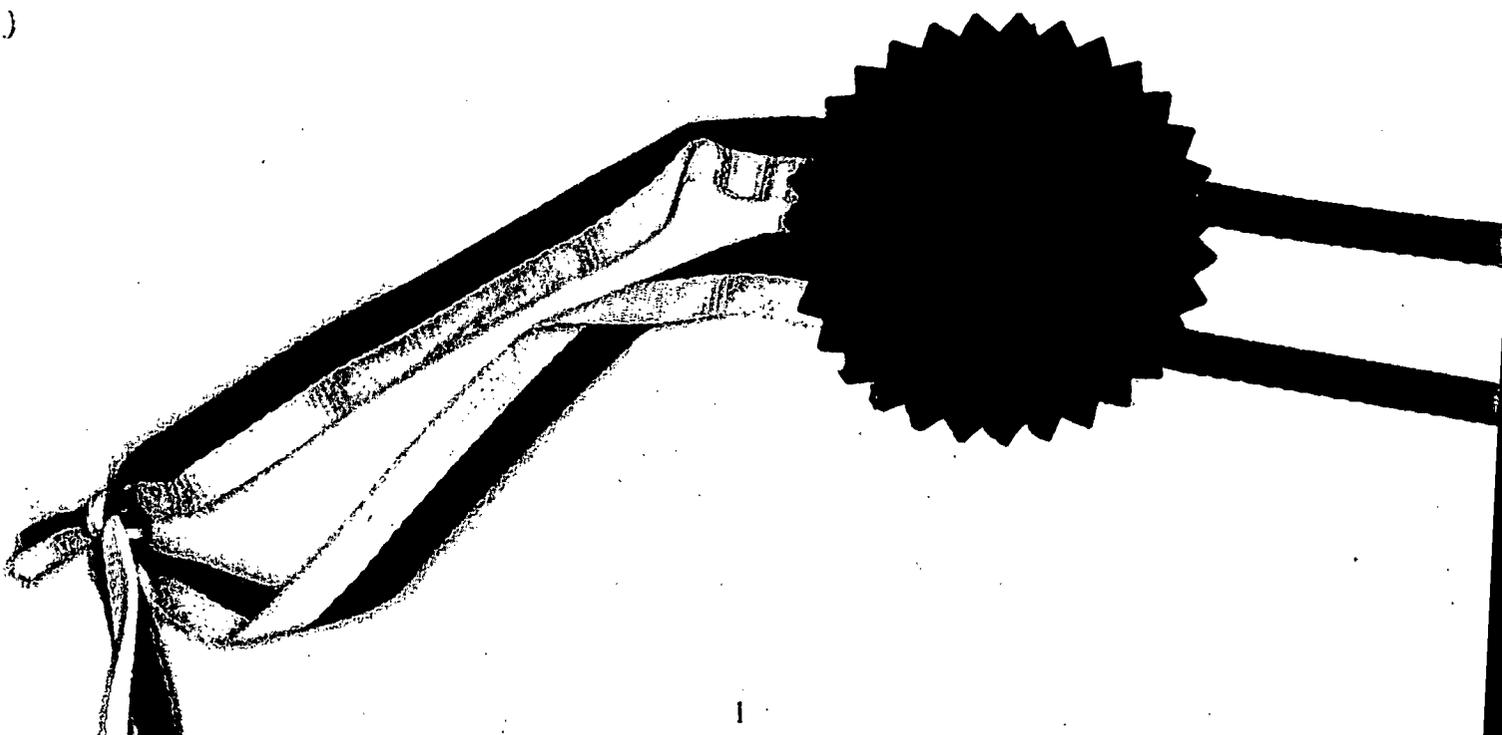
By: *M. Akram Malik*
Name: M. Akram Malik
Title: Secretary
Economic Affairs Division

Witness by:

By: *Peter W. Bodde*
Name: Peter W. Bodde
Title: Chargé d'Affaires, a.i.
U.S. Embassy

By: *Hina Rabbani Khar*
Name: Hina Rabbani Khar
Title: Minister of State for Economic
Affairs

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Hina Rabbani Khar
Minister of State

Phone : 092-051-9203439
Fax : 092-051-9214716

No. 6(6)US/A&P/2004
Government of Pakistan
Ministry of Economic Affairs & Statistics
(Economic Affairs Division)

Islamabad, the October 1, 2004

Dear Mr. Larson,

This has reference to your meeting with the Finance Minister in Washington and the subsequent discussions held with the U.S. Mission in Pakistan.

I would like to indicate that Government of Pakistan has fairly rich and broad based programme of second generation reforms that it would undertake over the medium term. The broad features of this programme are as shown in the annexed exhibit. It is further informed that this programme is embedded in considerable detail in the Poverty Reduction Support Credit (PRSC) which we are currently negotiating with the World Bank. The PRSC will envisage periodic review of performance under a number of target reforms specified therein.

It is understood that the budgetary support component of the US assistance of a billion dollar over the next five years will go in supporting and facilitating the implementation process of these reforms. We are in agreement that each year we will review with US authorities the performance of reforms along the lines indicated in the exhibit as well as achieved under the PRSC and that implementation of reforms would facilitate release of the next tranche of budgetary assistance.

I hope this relatively simple and flexible arrangement would ensure effective utilization of US budget support assistance.

Regards,

Yours sincerely


(Hina Rabbani Khar)

Mr. Alan Larson,
Under Secretary of State for Economic Affairs,
The State Department,
United States of America,
Washington D.C.

Fiscal Year 2005 Objectives

Pillar I: Growth and Macroeconomic Stability

- Maintain a satisfactory macroeconomic framework consistent with Poverty Reduction Strategy Plan (PRSP) targets, specifically public debt and fiscal deficit targets.
- Satisfactory progress in implementing the Fiscal Responsibility Law.
- Make further incremental progress in implementing telecommunications privatization policy.
- Demonstrate incremental progress in implementing the Transparent Pricing Framework and bi-yearly adjustment of the retail tariffs for natural gas, as supported under the Structural Adjustment Credits (SACs) as per the PRSP.
- Demonstrate incremental progress implementing power sector reforms, as outlined in the PRSP, beginning with the Government of Pakistan's expeditious completion of a comprehensive action plan.

Pillar II: Investing in Human Capital and Private Sector Development

- Continued implementation of fiscal decentralization reforms as per PRSP.
- Satisfactorily implement human development programmes reforms articulated in the PRSP, particularly those related to improving the quality of and expanding access to education and healthcare, and meet PRSP expenditure targets for health and educating, as a percentage of GDP.
- Initiate by August 2004 a public-private sector dialogue focused on identifying and implementing key economic reforms to boost private investment in Pakistan and to eliminate barriers to establishing small businesses.
- The United States will consider as possible additional shared objectives the policy recommendations resulting from this dialogue and other reforms, as agreed by the two governments.
- The United States will continue to support Pakistan's efforts to improve its investment climate and boost investment through expanded U.S programmes including those implemented by the Export-Import Bank of the United States, the Overseas Private Investment Corporation, and the U.S Trade Development Agency. The United States also support expanded private sector efforts in this area.

Fiscal Year 2007 (July 2006 – June 2007) Shared Objectives

Pillar I: Growth and Macroeconomic Stability

- Maintain a satisfactory macroeconomic framework, which meets the Government of Pakistan's fiscal objectives for FY07 in accordance with the Poverty Reduction Strategy Paper (PRSP) and consistent with Fiscal Responsibility Law, specifically with respect to public debt, revenues and deficit targets.
- Continue efforts to expand the tax base and increase the tax revenue/GDP ratio, both through ongoing improvements in tax administration and appropriate reforms in tax policy that ensure all productive sectors of the economy make a fair contribution to the Government's revenues.
- Continue to implement power sector reforms, consistent with objectives of the PRSP and agreed for the World Bank's Poverty Reduction Support Credit II, including privatization and reduction of government subsidies to the energy and power sectors.
- As per the goals of the PRSP, continue efforts to create competitive markets and reduce direct or implicit consumer and producer subsidies.
- Continue efforts to reduce costly and distorting subsidies for fertilizer and agricultural staples.
- Reduce distortions in the agricultural market, including support prices for key commodities that increase the cost of such products for consumers.
- Achieve passage and satisfactory implementation of the Anti-Money Laundering Act, to include the creation of a Financial Intelligence Unit.

Pillar II: Investing in Human Capital and Private Sector Development

- Satisfactorily implement human development programs/reforms articulated in the PRSP and PRSP Progress Reports, particularly those related to improving the quality of and expanding access to education and healthcare; increase health and education spending (as reported by the PRSP Secretariat, for example in its Progress Report) as a percent of GDP, consistent with the PRSP.
- As appropriate, implement recommendations made by Competitiveness Support Fund Sectoral Working Groups focused on identifying reforms to increase growth and investment in key economic sectors and eliminate barriers to establishing small businesses. Drawing on past studies, identify new areas for de-regulation and reform.
- Following up on the World Bank's "Doing Business 2006" report on business climate, which identified Pakistan as one of the top 12 economic

reformers in the world, continue to implement business climate reforms in those specific areas where Pakistan's performance lagged, such as: enforcing contracts; streamlining license and permit requirements; facilitating access to credit and credit information; and facilitating import and export procedures.

- Continue implementation of fiscal decentralization reforms as per the PRSP and PRSP Progress Reports leading to a meaningful increase in resources spent at the district level, with appropriate monitoring.
- The United States will continue to support Pakistan's efforts to improve its investment climate and boost investment through U.S. programs, including the Reconstruction Opportunity Zone initiative and programs implemented by the Export-Import Bank of the United States, the Overseas Private Investment Corporation, and the U.S. Trade Development Agency. The United States also supports expanded private sector efforts in this area.

Pillar III: Earthquake Relief and Reconstruction

- As part of the United States and Pakistan shared commitment to sustaining the rebuilding efforts of communities devastated by the October 2005 earthquake, in (U.S.) fiscal years 2007-09 the United States will seek to contribute \$50 million in grant assistance to earthquake reconstruction activities, while Pakistan will separately direct \$50 million equivalent in local currency proceeds of its U.S. budget support assistance toward earthquake reconstruction expenses.
- Domestic and international funds contributed to the Earthquake Reconstruction and Rehabilitation Authority (ERRA) will be utilized as part of a comprehensive earthquake reconstruction plan. In order to insure transparency and accountability of reconstruction assistance, Pakistan will ensure that activities conducted by the ERRA are audited by the Auditor General of Pakistan and/or an internationally recognized, independent accounting firm.

Monitoring:

- The governments of Pakistan and the United States agree to engage in ongoing consultations and to meet around the time of the Pakistan Development Forum for a dialogue on achievements of the Shared Objectives (as discussed). Prior to that meeting, the Government of Pakistan agrees to share with the United States Government information in a brief report on the performance of the FY07 shared objectives, with updated information relative to the Pakistan government's goals and targets.

Monitoring Side Note:

Objectives and Performance for Review:

As mentioned under "Monitoring," representatives of our governments will review achievements of the FY07 Shared Objectives, including performance of the Government of Pakistan's macroeconomic framework relative to the government's targets:

- Fiscal deficit as projected by State Bank of Pakistan (SBP) in its most recent report for FY07.
- Central Board of Revenue (CBR) tax revenue collection, for the half year and most recent months, relative to the corresponding CBR targets.
- Net domestic government budgetary support borrowing for the half year and up to the most recent months, relative to the Government of Pakistan's annual target (as amended by most recent SBP policy statement)
- Fiscal support for the energy and power sector, for the half year and up to most recent months, relative to government targets and last year's levels.
- PRSP education and health spending, most recent month available, relative to annual targets (2.25% and 0.92% of GDP, respectively) as per the December 2003 PRSP.
- Projected and actual subsidies for fertilizer and staple foodstuffs (sugar, wheat and pulses), and compared to previous years actual spending.
- Projected and actual government spending if any to maintain the price of wheat and lentils under the agricultural support price system, and compared to previous years actual spending.